Stamper Capital & Investments, Inc.

"Focusing on Upside Potential with Downside Protection Since 1995."

Investing in Municipal Bonds is Not a D.I.Y. Project

May 18th, 2011

For individual investors, some asset classes may prove to be too time consuming or complex to handle on their own and still get decent returns, and municipal bonds are definitely one of them. Many times these investors turn to mutual funds to gain the benefit of expert management of these investments, but do not realize that they could easily be paying too much (numerous management and sales fees and other hidden costs reducing their return) or taking on additional risks that are unnecessary (for example, mutual funds have redemption risk – the risk that a large number of shareholders may suddenly panic or need to liquidate a good portion of the mutual fund holdings – which causes the manager to sell assets at worse prices – hurting the return of the investors to did not choose to redeem at the time – this happens more often than one might think!). However, if they are the type of investor who needs the tax-advantages that owning municipal bonds can offer, they are probably also a qualified investor who can benefit from a separately managed municipal bond account managed by an expert fee-only Registered Investment Advisor.

Why are municipal bonds so hard for individuals to buy on their own? Focusing on the secondary market in general, there are two ways to buy muni bonds – on the 'retail side', typically where average individual investors trade, or the 'institutional side', where the 'big boys play' (professionals, institutions like mutual funds, insurance & pension trusts, and high net worth managers, like Stamper Capital) trading at better prices due to a volume discount. It is rare for retail investors to have opportunities to buy bonds at the prices institutional investors can, especially after paying retail commissions. Even if investors buy into a bond fund, they still have to pay all the various management, administrative, and sales fees for the fund itself, on top of the institutional commission rates the fund manager pays, and as we all know, fees and commissions eat into return on investment.

In addition to the problem of retail vs. institutional commissions, how can an investor know what price they should be willing to pay? Individual bonds do not usually have convenient price graphs and analyst recommendations that stocks and mutual funds do. How does a retail investor know if the price of a bond is fair for the type of risk vs. reward taken? It may or may not be worth it, depending on their level of risk tolerance. It takes years of experience studying the market and closely researching individual bonds to have a sense of what price you should pay to get the best possible return on your investment, and retail investors are already at a disadvantage due to higher commissions and fees to begin with.

Investors need to know that not all municipal bonds are the same. Buying municipal bonds are not like buying individual stocks or shares of a mutual fund – buying one share of PIMCO Total Return fund is pretty much the same as buying another share of the PIMCO Total Return fund, and buying one share of Apple stock, is just like buying any another share of Apple stock (not considering share class, that's a whole other topic!). However, buying one City of Los Angeles District of Water and Power bond is NOT the same as buying another Los Angeles DWP bond. This is because a bond issuer does not issue all bonds at the same time, or the same way, or for the same reason.

For example, an investor could buy a LADWP bond that was issued in 2009 at 4% coupon/yield and also buy an LADWP bond issued in 1974 at 8% coupon/yield. One could be secured by an escrow account fully funded with US Treasury Bonds (aka the full faith and credit of the US Government), while the other might only be backed by DWP customer net revenues. One bond might have been issued to upgrade some water treatment plant equipment, and the other could have been issued to pay off an older bond, which was originally issued to refinance a loan, which was originally taken out to buy new employee work trucks in 1974 (which, by 2011, DWP ratepayers are still paying off a heap in a scrap yard!).

Another subject for muni investors to consider is the somewhat obscure notion of balancing interest rate risk with reinvestment risk. When someone buys a bond, they know that it will eventually mature and will get their principal returned. The number of years until maturity indicates what they think will be happening with interest rates in the future – do they think interest rates on new bonds will be higher or lower in one, five, ten, twenty years? By buying a bond today with a one year maturity, the investor is hoping that interest rates will be higher then than they are now, and would be able to reinvest your money at a better rate. Conversely, by buying a twenty year bond, the investor is trying to lock in what they think is a good interest rate today, because they think rates will be lower in the near future. All of this has to do with what direction the investor thinks interest rates are headed, and involves a really good sense of the markets, the health of the economy and closely following the Fed.

Each of the subjects discussed above barely scratches the surface of all the factors that go into municipal bond investing. The point is that this asset class takes considerable time and expertise to get the best return on your money, especially for sophisticated investors with $1 million or more to invest. Stamper Capital & Investments, Inc. established in 1995, is a fee-only institutional municipal bond registered investment advisor. Call us today at (949)673-5787 to speak with our Portfolio Manager, B. Clark Stamper, to arrange your complimentary Municipal Bond Portfolio Review and discuss how you can start your own Federal and/or State tax-free income earning Separately Managed Account.

Stamper Capital & Investments has been positioning our clients over the past several years in preparation of what we are forecasting. If we are right, the past three years will seem like a walk in the park compared to what is coming. We intend our clients to not only just 'survive' what is to come, but to be in a position to make once-in-a-lifetime investments at fire-sale prices. If you are interested in discussing our forecast further or would like to inquire about privately managed municipal bond accounts, please contact Stamper Capital & Investments at (949) 673-5787 or email us at **separatelymanagedaccounts@risk-adjusted.com**.

Stamper Capital & Investments, Inc. provides portfolio management services exclusively for institutional and high net worth accounts and does not sell the mutual funds for which it is or was a sub-Advisor. Also, please note: purchasers of mutual funds must receive a copy of a particular mutual fund's prospectus before a purchase is made.

Past performance does not guarantee future results, and current performance may be higher or lower than the performance data quoted. Investment return and principal value of an investment will fluctuate so that investor's shares, when redeemed, may be worth more or less than their original cost.

Returns - Figures quoted are total returns calculated for the share class and time periods shown. Performance includes the reinvestment of income dividends and capital gains distributions. Performance does not reflect the deduction of taxes that a shareholder would pay on a fund distribution or the redemption of fund shares. Please go to Morningstar's and/or Lipper's websites for more information.
